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March 15, 2019

**VIA ELECTRONIC SUBMISSION**

Ms. Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, D.C. 20551

Mr. Robert E. Feldman  
Executive Secretary  
ATTN: Comments/RIN 3064-AE80  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, D.C. 20429

Legislative and Regulatory Activities Division  
Office of the Comptroller of the Currency  
400 7th Street, SW  
Suite 3E-218  
Washington, D.C. 20219

**Re: Comments on the Proposed Rule, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts* (RIN 1557-AE44; RIN 7100-AF22; RIN 3064-AE80)**

To Whom It May Concern:

**I. INTRODUCTION**

CoBank, ACB (“**CoBank**” or the “**Bank**”) submits this letter in response to the request for public comment set forth in The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency’s (together, the “**Banking Regulators**”), Proposed Rule, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts* (the “**Proposed Rule**”).<sup>1</sup>

CoBank is a national cooperative bank serving vital industries across rural America. The Bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. CoBank is one of the four banks of the Farm Credit System (the “**System**”), a nationwide network of banks and retail lending associations chartered to support the

<sup>1</sup> See Notice of Proposed Rulemaking, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64,660 (Dec. 17, 2018), <https://www.govinfo.gov/content/pkg/FR-2018-12-17/pdf/2018-24924.pdf> (the “**Proposed Rule**”).

borrowing needs of U.S. agriculture and the nation's rural economy. In addition to serving its direct retail borrowers, the Bank also provides wholesale loans and other financial services to 22 affiliated Farm Credit associations serving approximately 70,000 farmers, ranchers and other rural borrowers in 23 states around the country. The Bank's members consist of: agricultural cooperatives; other food and agribusiness companies; rural power, communications and water cooperatives and companies; rural community facilities; Agricultural Credit Associations (Associations), which are regulated, farmer-owned financial institutions and members of the System; and other businesses that serve agriculture and rural communities.

## II. COMMENTS OF COBANK

CoBank appreciates the participatory process through which the Banking Regulators seek to refine their respective derivatives-related capital requirements for advanced approaches banking institutions (each an "**AA Bank**") to be more risk sensitive and to better account for common risk-reducing practices like netting and the posting of variation and initial margin. However, as explained in further detail below, if finalized as proposed, the Proposed Rule would: (A) not properly account for the risk-reducing characteristics of segregated initial margin that futures commission merchants ("**FCMs**") hold in trust for clients; (B) undermine congressional intent; and (C) fail to recognize the risk-reducing features of cross-collateralized hedged loans.

### A. **The Proposed Rule does not Properly Account for the Risk-Reducing Characteristics of Segregated Client Initial Margin**

The Proposed Rule, like the Current Exposure Method it modifies, does not properly account for the risk-reducing characteristics of segregated client initial margin by mischaracterizing the nature of such collateral. Specifically, the Proposed Rule would require FCMs to use a modified version of SA-CCR to determine on- and off-balance sheet amounts of derivative contracts for purposes of calculating the Supplementary Leverage Ratio.<sup>2</sup> The calculation improperly treats client initial margin held in segregated trust accounts as providing additional leverage to the FCMs. The calculation also does not allow an FCM to offset its guarantee of a client's trade with the initial margin posted by that client with respect to that trade. This approach ignores the fact that significant regulatory constraints and contractual limitations restrict an FCM's access to these trust deposits that are designed to be risk-reducing buffers to protect against client defaults. Put differently, by regarding restricted client initial margin as a liability on the FCM's books as though the FCM itself owned the collateral, the Proposed Rule overlooks (i) the rights enjoyed by the true beneficial owners of such collateral, and (ii) the duties of the FCM trustees under such arrangements. The likely consequence of the Proposed Rule failing to account for this critical risk-reducing function of segregated client margin by means of an offset is increased costs for non-financial derivative end-users, which could translate to a reduction in the availability and use of clearing services.

As such, CoBank respectfully requests that the Banking Regulators modify the Proposed Rule to properly account for the risk-reducing role of initial margin. Doing

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<sup>2</sup> See Proposed Rule at 64,683.

so would be consistent with the changes being considered with respect to the Basel Leverage Ratio framework's treatment of cleared derivatives collateral.<sup>3</sup>

**B. The Proposed Rule is in Conflict with Congressional Intent as it Undermines the End-User Exception and Financial Cooperative Exemption**

Among other things, Title VII of the Dodd-Frank Act imposes capital and margin requirements on swap dealers but not on end-users.<sup>4</sup> Further, Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("TRIPRA"),<sup>5</sup> made clear that Congress' intent was to permit non-cleared swaps used for hedging commercial risk to be exempt from Dodd-Frank Act's clearing and initial and variation margin requirements by establishing, among other things, an exception for end-users (the "End-User Exception") and exemption for financial cooperatives (the "Financial Cooperative Exemption") from such requirements.<sup>6</sup> Congress provided the End-User Exception and Financial Cooperative Exemption in recognition of the risk-reducing benefits of hedging and the negative impact to derivative end-users' working capital liquidity as a result of margining. However, the Proposed Rule would increase exposure amounts to end-users' unmarginated hedging transactions which could (i) result in significantly higher hedging costs for such end-users, (ii) cause them to post cash collateral, diverting resources away from more productive uses, or (iii) force a greater share of transactions into clearing, setting up a potential conflict with the CFTC's clearing exception and exemption for certain swaps entered into by end-users and financial cooperatives, respectively.<sup>7</sup>

By effectively raising the cost of non-cleared transactions, through unfavorable regulatory capital charges on initial margin, the Proposed Rule would conflict with the Congressional intent underlying the End-User Exception and Financial Cooperative Exemption. As such, CoBank requests that the Banking Regulators amend the Proposed Rule to recognize the risk-reducing benefits of initial margin in a manner that aligns with Congress' intent to ensure that swaps clearing and margin requirements are not implemented in a way that would be "punitive to end-users"<sup>8</sup> or "punish those who are trying to hedge their own commercial risk."<sup>9</sup>

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<sup>3</sup> See Basel Committee on Banking Supervision, Consultative Document – Leverage ratio treatment of client cleared derivatives 2 (Oct. 2018), <https://www.bis.org/bcbs/publ/d451.pdf>.

<sup>4</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act § 731, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> See Terrorism Risk Insurance Program Reauthorization Act of 2015, tit. 3, Pub. L. No. 114-1, 129 Stat. 3 (2015).

<sup>6</sup> TRIPRA extended an existing end-user exception, and a financial cooperative exemption, from mandatory clearing, both of which were available CFTC regulations, to apply to margin. See note 7, *infra*.

<sup>7</sup> 17 C.F.R. §§ 50.50 and 50.51, respectively.

<sup>8</sup> See Letter from Senate Committee on Banking, Housing, and Urban Affairs Chairman Christopher Dodd and Senate Committee on Agriculture, Nutrition, and Forestry Chairman Blanche Lincoln to House Financial Services Committee Chairman Barney Frank and House Committee on Agriculture Chairman Colin Peterson (June 30, 2010), <https://archives-agriculture.house.gov/sites/repUBLICans.agriculture.house.gov/files/pdf/letters/DoddLincolnEndUserLetter.pdf>.

<sup>9</sup> *Id.*

**C. The Proposed Rule Fails to Recognize the Risk-Reducing Features of Cross-Collateralizing Loans with Hedges**

It is common practice for lenders to extend credit on a secured floating rate basis to non-financial derivative end-users, subject to loan agreements that obligate the borrower to enter into derivative transactions with the lender to swap the floating rate for a fixed rate. Frequently, the security agreement accompanying such loan agreements provide the lender with broad access to the collateral securing the loan to cover borrower defaults as to (i) debt service payments under the loan, and (ii) payments under the swap transaction. This is the preferred practice because it avoids situations in which a lender must advance funds to a borrower to facilitate the borrower meeting the lender's margin call. This approach, while efficient from an economic perspective, would likely prove costly under the Proposed Rule. In short, the Proposed Rule would not recognize swaps in the structure outlined above as being margined for regulatory capital purposes, disregarding a well-regarded risk mitigation tool.

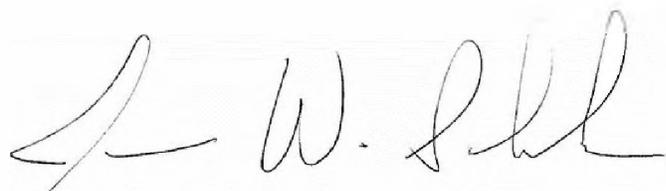
As such, CoBank requests that the Banking Regulators amend the Proposed Rule to consider cross-collateralized loans and hedges as being variation margined.

**III. CONCLUSION**

CoBank appreciates this opportunity to provide input on the Proposed Rule and respectfully requests that the comments set forth herein are considered. In addition to the foregoing comments, CoBank endorses, and recommends for consideration, comments submitted in response to the Proposed Rule by the National Council of Farmer Cooperatives.

If you have any questions, please contact the undersigned.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "J. W. Shanahan". The signature is written in a cursive style with a large initial "J" and "S".

James W. Shanahan, CFA  
Vice President – Financial Regulatory  
Compliance